

5/12/81

Financial Markets



Irving Trust

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Economic Research &
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Friday
(Noon)

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Interest rates lurched upward this week as the conviction spread that the Federal Reserve had indeed tightened its policy stance. Arguably the severest shock centered on the bond market, where, in the face of enormous prospective supplies of new offerings, yields rose to record levels.

The question of moment during the early part of the week was whether, and to what extent, the Fed was tightening its policy stance. It seems very clear that the Fed's draining of reserves last Friday was an overt move to restrict reserve availability, no doubt in response to the very small decline in M-1B announced that night, following increases totaling \$8.5 billion in the preceding two weeks. On Monday, the funds rate moved up sharply, but that evinced no Fed concern--as would be reasonable when sharply higher levels of borrowing were anticipated for late in the week.

A good part of the dramatic surge of the funds rate on Tuesday and Wednesday, however, can probably be attributed not only to the Fed tightening, but also to a major disruption to the reserves market caused by April tax payments. From a more or less normal level of around \$3 billion earlier in the week, balances in Treasury accounts at the Fed soared on Tuesday and Wednesday to more than \$5 billion, draining a very substantial amount of reserves from the banking system. The problem probably was that banks had insufficient securities collateral to cover a large portion of the tax receipts flowing into their Treasury tax and loan (TTL) accounts, so that they remitted the excess to the Treasury's Fed account--thus draining reserves. For its part, the Fed did everything possible to deal with the problem. Direct deposits from the Treasury to the TTL accounts were arranged on both days but were inadequate in view of the collateral shortage. The Fed also entered the market to do RPs on both days, but there again collateral in dealer hands was extremely scarce, so that probably only a modest amount of reserves was injected via that channel. The result was extreme pressure on the funds market toward the end of the statement week. Indications are that the problem was on the way to being resolved by today, which is a payment date for Social Security benefits. The Treasury call was relatively small, suggesting that the excessive Treasury balances at last might be pared back.

While there is no doubt that the Fed moved to restrict the availability of reserves to banks, the immediate outlook for interest rates in general and the funds rate in particular is less clear. To the extent that a portion of the lofty level of the funds rate reflects a temporary distortion, funds should be expected to trade down--but the process could take several days or even a few weeks, unless the Fed makes an overt move, which we consider doubtful. Moreover, even if the money stock decelerates soon, the Fed likely would not move quickly toward ease, having firmed so recently.

As a result, the securities being offered in the Treasury's three-part refunding auctions next week should set record auction yields. We continue to look for lower rates later in the year, however.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.



	5/1/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	18.00%	17.50%	18.50%
Effective since	4/30/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	19.75	14.75	14.50
Repurchase Agreements	17.00	14.50	11.75
U.S. Treasury Issues			
Bills			
3 months	15.69	14.24	10.65
6 months	15.48	14.74	10.92
1 year	15.14	14.57	10.75
Coupons			
2 years	14.76	14.40	10.56
4 years	14.45	14.14	10.62
7 years	14.21	13.90	10.56
10 years	14.08	13.71	10.52
Long Bond	13.58	13.19	10.69
Negotiable Certificates of Deposit-Secondary Market			
1 month	16.80	15.00	12.55
3 months	16.75	15.25	12.55
6 months	16.45	15.45	12.45
1 year	16.00	15.50	11.60
Banker's Acceptances			
1 month	16.80	15.00	12.32
3 months	16.75	15.20	12.42
6 months	16.50	15.45	12.50
Eurodollar Deposits			
1 month	17.63	15.55	14.00
2 months	17.50	15.60	14.13
3 months	17.25	15.65	14.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.00	10.00	11.00
1 month	15.00	14.50	11.25
3 months	15.00	14.00	10.75
Bank Holding Companies			
1 month	16.50	14.75	12.00
Dealer Placed:			
3 months	16.00	14.75	12.00
New AA Corporate Utility Bond	16.50	16.15	13.70
Tax Exempt			
6 month Project Notes	7.80	7.40	6.25
1 year AAA Bond	7.40	7.25	6.05
5 year AAA Bond	8.45	8.20	6.10
20 year AAA Bond	10.20	10.10	7.30

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

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